

JPMorgan Investor Services

thought

IDEAS FOR
A CHANGING
GLOBAL ECONOMY
Q4/2004

Weathering The Regulatory Storm

The Dynamic New Era
of Compliance
with Global Regulations

thinking out loud

If 2004 is any indication, 2005 will be another dynamic year in global financial services. The level of change, particularly with regard to regulatory and compliance issues, is unparalleled in recent history. Compliance with new regulatory rulings is a global challenge and industry participants are understandably experiencing a collective level of anxiety with respect to determining the appropriate level of oversight and conformity.

As a full-service service provider with a breadth, depth and a level of expertise few in the industry can match, JPMorgan Investor Services is uniquely positioned to share our knowledge of regulatory, compliance and other important industry issues to help you to identify ways to conduct business more efficiently. In this issue of *Thought*, JPMorgan Investor Services' industry experts focus on several topical global regulatory and compliance issues.

In our cover story, "Weathering the Regulatory Storm" (page 3), we follow up on a series of client forums we hosted on the SEC's October 5, 2004 deadline to implement the "CCO rule." Neil Henderson, Securities Processing and Fund Services executive; Virginia Meany, Fund Services Western Hemisphere executive and team, provide important insights to help clients implement the next phase of CCO rule requirements.

As a result of historic new regulations in China, the country's insurance companies are now permitted to invest offshore. In "China's Regulations Offer First Time Opportunities," (page 14) Steven McCullough, business manager in our Asia Pacific team, considers this and other regulatory changes in China, including the importance of the Qualified Domestic Institutional Investor or QDII status for global custodians and their clients. And in "Regulation: Will Europe's Financial Services Action Plan Succeed?" (page 11) Sheenagh Gordon-Hart, Strategy, Research and Government Affairs Executive in our Europe, Middle East & Africa team, focuses on important regulatory developments in Europe including the EU Taxation of Savings Directive.

New and changing regulations have also meant that clients have additional reporting needs. Craig Heatter, Performance Measurement, Analytics and Risk Management executive, presents Investor Services' response to this need. In "Any View, Any Time... The Transformation of VIEWS" (page 25), he talks about *VIEWS Performance*, JPMorgan Investor Services' exciting new reporting suite.

On behalf of the entire JPMorgan Investor Services team, I want to wish you a healthy and prosperous New Year. We look forward to continuing to provide you with flexible and forward-looking solutions that will help you meet the demands of our dynamic marketplace.

Your questions and comments are always welcome and can be sent to Thought.magazine@jpmorgan.com.



Tom Swayne
Investor Services Business Executive



Tom Swayne,
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weathering regulatory storm

It was not long ago that the words *mutual fund* conjured up images of a conservative, middle of the road way for investors to participate in the most sustained bull market in history. However, say the words today and many industry participants think of something quite different... regulation.

Few would argue that financial institutions are currently under a tremendous amount of regulatory pressure. Heightened awareness around terrorism, scandals involving late day trading, market timing and other improprieties are just a few of the reasons why the financial services industry finds itself at the center of a regulatory hurricane. With the large onslaught of federal regulations, industry participants find themselves faced with navigating a plethora of new and complicated rules and requirements, many of which have changed the way business is conducted.

"Whether it's Sarbanes Oxley, the Patriot Act, the European Savings Directive, or the Chief Compliance Officer Rule, new regulations are emerging from every direction, in countries around the world," says Neil Henderson, Securities Processing and Fund Services business executive, JPMorgan Investor Services. "The increasing burden of compliance responsibilities and the level of adherence required will continue to escalate, increasing pressure on clients not only to improve their compliance processes to meet today's requirements, but also continue to enhance and adopt best practices."

"This is a journey. It's not like the October 5th deadline — that required mutual funds and their advisors to appoint Chief Compliance Officers (CCO) and implement comprehensive programs to prevent violations of SEC regulations and securities laws — passed and we could all return to the way it

used to be. These new mandates require heightened scrutiny, and JPMorgan very much wants to be part of the journey with you,” notes Virginia Meany, Fund Services Western Hemisphere business executive, JPMorgan Investor Services, at a series of client forums JPMorgan Investor Services hosted in New York and Boston on the CCO rule. The forums were designed to help clients navigate the maze of new regulatory requirements and to provide them with information on how JPMorgan Investor Services Compliance Solutions Program could help transform operational risk management from a regulatory requirement into competitive advantage.

“We believe that as an organization, and as a top service provider in the industry, that we need to be and very much want to be, in a leadership role as we define the response and define the best practices in the industry regarding these and other regulations to come,” Meany said.

Mutual Funds Appoint CCOs

Critical new regulations include the Investment Company Act of 1940 Rule 38a-1, and the Investment Advisors Act of 1940 Rule 206(4)-7, which went into effect this past October 5th. The rule requires mutual funds and investment advisers to appoint a CCO and implement comprehensive policies and procedures to prevent funds and advisers from violating federal securities laws. Under the rule, fund boards must annually approve the policies and procedures of service providers, oversee those providers, and policies and procedures annually. Where the SEC’s Office of Compliance Inspections and Examinations (OCIE) counsels participants to, “Use the opportunity that the new rule presents to question past practices...”¹ considerations such as costs and the practicality of implementation are serious concerns for clients.

An October 2004 study by Cerulli Associates, a Boston-based research and consulting firm, states that, “Rising compliance costs continue to impact asset managers’ profitability. As firms spend more time, resources, and money to stay up-to-date on current and proposed regulation, staff, budgets, and outsourcing are expected to increase.”²

Further, www.ignites.com recently reported on that same Cerulli study, which asked 40 asset management firms, including more than 20 mutual fund managers, to grade the importance of seven different factors that impact profits. When asked to rank costs that harm profitability on a scale of zero to seven, with seven representing the most significant items, compliance issues scored a 4.38 on an industry wide basis.³

“It’s true that we’ve seen an enormous number of new rules over the last two years. For example, the SEC has significantly stepped up its scrutiny of daily mutual fund valuation placing a greater burden on fund administrators to come up with ways to fairly value shares and ultimately, discouraging trading abuses to safeguard long-term shareholder rights. SEC regulations are nothing new,” says Meany. “Regulators have had to respond to political pressure as people began to ask how situations like Enron and a WorldCom could happen. As a result, they are getting increasingly aggressive in their rulemaking and oversight.”

Not just a U.S. development, the level of focus on regulatory issues is intensifying in Europe and Asia as well (see also “Regulation: Will Europe’s Financial Action Plan Succeed?” page 11, and “China’s Regulations Offer First Time Opportunities,” page 14). “Regulators realize that if it can happen in America, it could happen in their country too,” says Meany. “There are a host of new regulations globally that require the financial industry and public companies to perform assessments on their key processes.” The considerable amount of additional work required of companies to become compliant with the new regulations is unarguable, but Meany suggests that looking at the regulations as an opportunity to implement more efficient business practices can be a benefit.

Value-Added Support

“This regulatory environment is unlike any we’ve seen in recent history, but it is a reality we have to face,” Meany says. “Our goal is to work beyond just providing policies and procedures. We also want to help clients establish

“Regulators realize that if it can happen in America, it could happen in their country too.”



“This regulatory environment is unlike any we’ve seen in recent history, but it is a reality we have to face.”

best practices and facilitate due diligence, offering clients tools that can assist and support them to be as responsive to the regulations as possible.”

In addition to the CCO Client Forums, the Investor Services team worked during 2004 to support its custody and full service fund accounting and administration clients with the CCO rule in a number of ways. By consulting with clients and industry experts, Investor Services developed a program that included providing detailed summaries of its compliance policies, procedures and controls. This cut down on the volumes of documents clients were required to review before the deadline. The firm also provided one-on-one support to clients and fund boards to help them prepare for representing to their own fund board that their compliance program is adequately designed.

Rule 38a-1 designated that CCOs were to have been appointed by October 5th, 2004. Already, the OCIE has commenced telephone inspections of mutual funds and investment advisers, where each of its regional offices has or will contact area fund groups to question their compliance with the CCO rule. “It is more important than ever for CCOs to source solutions that help them satisfy regulatory requirements with exceptional reliability and work to relieve the ever increasing compliance related administrative burdens,” Meany explains.

The industry is currently in the implementation and monitoring period, as is required by the rule. This involves activating the CCO office and putting its mechanics into practice. Investor Services plans to continue to support clients with a range of core and premium services. Beginning in the second quarter of 2005, Investor Services will communicate an assessment of its control environment through internally generated client representation letters, and third party SAS 70 reports. Further, updates to already provided policies and summaries will also be disseminated annually. Investor Services is still investigating the possibility of obtaining a third party

report relating to operations not currently covered in the SAS 70, depending on the recommendations made by the American Institute of Certified Public Accountants (AICPA) regarding the report’s design. More frequent reporting, client due diligence visits, and other JPMorgan services are also available to clients. All of these measures are oriented around supporting CCOs in connection with their annual evaluation of compliance with policies and procedures that will likely result in faster evolution of those policies and procedures to industry best practices.

Michael Leary, vice president, senior manager Fund Administration, says, “Policies and Procedures were only the beginning. Clients have a challenging task in front of them: to be ready for the post October 5th CCO deadline.”

“Although work leading up to the October deadline was important, what may be the most challenging and significant components remain,” Leary explains. “Clients will need to continually refine the materials already completed and design programs to show compliance and effectiveness. This task is complicated by expected enhanced oversight by regulatory agencies in the near future,” says Leary, who was recently appointed JPMorgan Investor Services Compliance Solutions Program manager. Leary has 16 years of investment company and advisor experience. He is a certified public accountant and is active in many industry specific communities and organizations.

“One of the biggest challenges for clients now is to determine how to project a culture of compliance and demonstrate the letter and spirit of how they will digest the new regulations as an organization,” says Greg Pickard, associate general counsel JPMorgan Investor Services. “Although much work has been completed to meet the first phase of the CCO rule, we may still have the greatest challenges ahead in designing the monitoring and implementation oversight phase.

“As an organization, and a top service provider, we believe it is important to take a leadership role in developing best practices with regard to industry regulations,” Henderson says. “The bar for compliance standards continues to rise, and we will increasingly present clients with not only an overview of the current regulatory environment, but also a number of compliance-focused solutions designed to help them deal with the ongoing wave of new rules.” ○○○

For more information, contact Michael Leary at (617) 557-8753.

1. “Compliance in a Time of Change” by Jane Worthington, *Securities Industry News*, October 1, 2004.

2. “Asset Management: Conquering Compliance Challenges,” summary page, www.cerulli.com.

3. “Compliance is Biggest Drain on Firms’ Profits” by Tom Leswing, www.ignites.com, November 17, 2004.

compliance tools

JPMorgan Investor Services Compliance Solutions Program includes a range of industry-leading tools that can assist advisors and funds in their efforts to ensure that their policies and procedures are reasonably designed to prevent violation of the federal securities laws.

Compliance Reporting Services

JPMorgan Investor Services Compliance Reporting Services provide institutional investors with automatic exception-based information, highlighting potential violations of pre-agreed investment guidelines, external regulations and internal risk exposure limits.

“A number of the enhancements we’ve recently made to our compliance reporting services can add value for clients facing the SEC’s CCO requirements,” says Bill Miller, product manager Compliance Reporting Services, JPMorgan Investor Services. Among those enhancements is an internet-based workflow management

tool available through JPMorgan AccessSM that Miller says, clients can use to document the resolution process of a compliance event. “We’ve received positive feedback from our clients that this is assisting them not only with their daily monitoring process of portfolios, but also in audit process documentation.”

JPMorgan Investor Services Compliance Reporting Service team works with clients to define and tailor rules and reports to their individual needs. Tests can be applied at the portfolio or multiple composite levels based on factors including: issuer, country, credit quality,

JPMorgan’s i-VAULT!

“There was a time when reports that boards of directors received in conjunction with fund activity may have ended up in the trash,” says Christopher Redvers, business development JPMorgan i-VAULT! “But today’s regulatory environment requires that those reports must be included in the fund’s official records. Indeed, just about every new SEC rule that is adopted today has a record-keeping requirement that comes along with it,” he says.

For example, the CCO rule requires policies and procedures to be retained for a minimum of five years, in as pure and unadulterated a form as possible. Redvers

says certain rules allow for exclusive electronic storage which is a great benefit to clients. “Many of the new regulations are putting additional record keeping pressures on investment advisers,” Redvers explains. “Imaging offers many advantages,” he says. “The technology is much more affordable than it used to be. Physical storage is an important issue for clients, particularly those in high cost metropolitan areas. Freeing up real estate can ultimately lead to significant cost savings.” In addition to faster access to documents, with JPMorgan’s i-VAULT! solution there is no more waiting for boxes to be delivered from a far away stor-

Plexus Group

“The CCO requirement is just the latest in an ever expanding mandate from the SEC focused generally on brokerage practices and requiring investment managers to obtain best execution,” says Marie Konstance, director of Sales and Product Management for JPMorgan’s Plexus Group. Plexus has been in the business of helping investment managers document and benchmark *Total Transaction Costs* and improve best execution for 18 years. With its long standing sound methodology, today’s compliance executives can utilize Plexus to provide Equity Transaction Cost Analysis in support of the best execution mandate.

“Clients look to Plexus for any number of reasons,” says Konstance. “They are often

concerned purely with reducing their costs while others want to understand if their traders or brokers are doing the best job possible. But in today’s heightened regulatory environment, the primary motivation to utilize our services is to comply with the SEC mandate for best execution,” she explains.

Plexus’ Alpha Capture[™] Service provides compliance executives with objective and independent analysis to satisfy expanded regulatory requirements. Plexus is not dependent on revenue from brokerage or investment management. “Clients say one of the most appealing aspects of the Plexus product is that it is independent,” Konstance says. “Plexus is not affiliated with any broker. As part of Investor Services we are completely distinct.”

maturity, and asset type. These tests can be run on a daily, weekly, or monthly schedule. Worldwide, the service has dedicated compliance reporting teams who support clients to set-up the service, build appropriate rules and support the application on a daily basis. Reporting is customizable, and is available for viewing through the internet or JPMorgan AccessSM.

The Compliance Reporting Service covers a wide range of investment compliance categories, including the Investment Company Act of 1940 and Investment Adviser Act of 1940 compliance regulation. Over 5000 client-defined rules are

available, covering equities, fixed income, derivatives, money market and cash equivalent restrictions.

Clients not currently receiving JPMorgan Investor Services custody or accounting services can also access the services through third party compliance. This service allows clients to transmit data via JPMorgan Access regarding their accounts and holdings, using their own file formats.

“Essentially we bring all aspects of a compliance reporting program into one spot, which is easy to use and highly customizable for our clients,” Miller says.

“To get a client up on the system, we take their rule requirements, regulatory restrictions, fund mandates and any other reporting requirements they have. We then document and interpret them with the client. JPMorgan Investor Services Administrators are then responsible for building the rules and maintaining the system, and then delivering the compliance events back out to the client. ○○○

For more information on JPMorgan Investor Services Compliance Reporting, contact Bill Miller at (718) 242-7863.

age facility which enhances clients’ record management program.

“The scope of JPMorgan’s own businesses and our diverse and extensive records retention requirements have created our own need for a comprehensive records retention system,” says Redvers. Originally developed as an internal JPMorgan image archive system, what sets i-VAULT! apart from other providers’ solutions is that there is no need to purchase or maintain hardware and software in-house. Clients don’t have to maintain a staff to manage storage media and or update their software in five years

when the technology has changed. i-VAULT! provides the core storage that allows clients to focus on their core business functions rather than building an in-house imaging archiving system.

i-VAULT! also provides clients with long term access to their documents and data; uploaded images are available on the internet for years. In addition, tapes or CDs are available as back up. “We see this as a natural extension of the physical safekeeping services JPMorgan provides,” Redvers explains. “i-VAULT! can also deliver the benefit of back up to clients’ physical storage.”

“With the routine sweeps the SEC has conducted or what they refer to as ‘themed examinations’, and the volume of information that must be retrieved and produced, the benefits of i-VAULT! technology are quite significant,” Redvers says. ○○○

For more information, contact Chris Redvers at (212) 552-3601 or call 1-866-2-iVAULT (1-866-248-2858), or e-mail i.vault@jpmchase.com.

JPMorgan Plexus evaluates total cost by calculating commission, market impact, timing and opportunity costs. Utilizing its own proprietary benchmark, the PAEG/L, Plexus estimates costs to establish a comparison. “The PAEG/L is a way to determine — on average, considering stock price movement, liquidity, capitalization, and various other factors — how much a trade should cost.” Konstance believes the PAEG/L is a more appropriate measure of trade costs than other industry benchmarks. “It takes the difficulty of the trade and other factors into account, where other benchmarks, such as volume weighted average price (VWAP, a widely used measure of trade costs) do not,” she says. “It looks at the conditions that traders really trade in.”

With documentation also critically important to growing compliance requirements, Plexus monitors best execution on a quarterly basis by documenting unusual and high costs, creating ready made, independent reports that can be presented at board meetings or utilized for audit purposes. In addition, it creates broker activity reports that provide cost benchmarking comparisons, exception reporting and extensive broker performance analysis providing a consolidated package that may be permanently stored for best execution reports. All of this data can be accessed online as well.

Currently Plexus is helping over 200 financial institutions navigate the best execution environment. Konstance says, “Our clients have come to rely on our independent and

objective analysis and recommendations. This translates into solutions that are responsive to the SEC requirement by seeking to measure *Total Transaction Costs* and best execution, and that add value to our clients’ investment returns.” ○○○

For more information, contact Marie Konstance at (718) 242-3165 or visit our booth at the FRA Best Execution conference in New York, January 31–February 1, 2005.

Log on to www.plexusgroup.com to request a reprint of “Transaction Costs and Best Execution: Compliance and Measurement,” published in *Institutional Investor* by our chairman, Wayne Wagner.

final DOL automatic rollover safe harbor regulations:

implications & impact



By Lynn Shipman, Senior Counsel, JPMorgan Chase

As a JPMorgan Chase senior counsel, Lynn K. Shipman supports the firm's institutional pension, endowment and custody lines of business. Currently a member of the Tax Committee of the Investment Company Institute, Ms. Shipman has also served as a member of the American Bankers Association Trust Counsel Committee and was an appointed delegate to the 2002 National Summit on Retirement Savings. She has also served as a member of the Pension Committee of the Investment Company Institute and the Board of Advisors of the American Bankers Association Employee Benefits Trust School/Graduate School.

At long last, recent guidance by the Department of Labor spells out clear directives for pension plan sponsors regarding distribution of the accounts of both terminated plan participants with account balances under \$5,000 and missing plan participants in terminated defined contribution plans. By following a concise 'checklist' of conditions, plan sponsors can now follow uniform standards in pursuing closure. Here's how...

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGGTRA), Congress enacted a provision that required retirement plans to roll over the accounts of terminated participants whose benefits due exceeded \$1,000 (but did not exceed \$5,000) unless the participant affirmatively opted to receive cash. However, this EGGTRA provision was not to be effective until the Department of Labor issued guidance, which EGGTRA dictated was due by June 7, 2004. Those regulations have now been finalized, and do indeed provide guidance and establish a safe harbor for plan sponsors that automatically roll over the funds in a terminated employee's tax-qualified retirement plan account to an individual retirement account. The new regulation, which goes into effect March 28, 2005, creates several important conditions that must be satisfied by plan sponsors, as well as some key implications for both sponsors and institutions.

First, the Differences

There are a number of interesting differences between what the DOL originally proposed and its final regulations. The most notable of these is the fact that the DOL extended the safe harbor to rollovers of mandatory distributions of \$1,000 or less, plan sponsors could automatically cash out accounts valued at \$1,000 or less, but if a plan sponsor preferred to roll over these smaller amounts into an IRA, under the originally proposed regulation, the safe harbor protection was not available to protect the plan sponsor.

Second, while the proposed DOL rules were, by and large, regarded as favorable by the institutional community, there were a few aspects that had the institutional community up in arms. The most troubling of these was the fact that, while an institution could charge the new IRA accounts an initial set-up fee, ongoing administration fees were limited to the amount of income that the account earned. Since these accounts were required to be invested in stable value, short-term fixed-income type accounts, the limits on administration fees were clearly unattractive to potential IRA providers. Additionally, some argued that this restriction would ultimately limit the number of individual retirement plan providers that would be willing to accept rollover distributions in accordance with the safe harbor regulation.

In the DOL's final regulations, however, this restriction was eliminated, and now institutions are merely required to charge fees that are comparable to those charged for other IRAs. The DOL states that the "comparability standard" is sufficient to protect individual retirement plans from being assessed unreasonable fees.

Conditions for Safe Harbor Relief

To secure protection under the new safe harbor, fiduciaries must now satisfy six conditions:

Distribution Amount. Automatic rollovers are limited to distributions that don't exceed \$5,000. In short, the safe harbor applies to any distribution that is \$5,000 or less (no \$1,000 minimum anymore).

IRA Providers. Automatic rollovers may only be made to IRAs and individual annuities maintained at:

- ▶ A state or federally regulated bank or savings association (the accounts of which are FDIC-insured);
- ▶ A credit union (the accounts of which are CUNA-insured);
- ▶ An insurance company (whose products are protected by state guaranty associations);
- ▶ A mutual fund company (regulated under the Investment Company Act of 1940); or
- ▶ Another financial institution eligible to offer IRAs under Treasury Dept. regulations.

What's more, the distributing plan's fiduciary must enter into a written agreement with the IRA provider that specifically addresses the investment of rolled-over funds and attendant IRA fees and expenses.

Investments. Investments deemed permissible under the new rules must be designed to preserve principal and provide a reasonable rate of return. The preamble to the regulation notes that the following products would typically meet this requirement:

- ▶ Money market funds maintained by registered investment companies;
- ▶ Interest-bearing savings accounts and CDs of banks or similar financial institutions; and
- ▶ Stable-value products issued by regulated financial institutions that are fully benefit-responsive.

Fees and Expenses. IRAs receiving automatic rollovers may only provide for fees and expenses that do not exceed the amounts charged for comparable IRAs that are not established to receive automatic rollovers.

Participant Notices. Prior to using the safe harbor for an automatic rollover, participants must be furnished with a Summary Plan Description or a Summary of Material Modifications that not only explains the investment product in which the distribution will be invested, but also clarifies the extent to which the IRA fees and expenses will be borne by the individual alone or shared with the distributing plan or plan sponsor. A plan contact must also be specified.

Prohibited Transaction Class Exemption. The safe harbor is not available where the distributing plan fiduciary engages in a nonexempt "prohibited transaction" under ERISA in connection with the selection of the IRA provider or investment products. What this means is, the receipt by a plan fiduciary of compensation from a financial institution as a result of selecting that financial institution

would ordinarily constitute a prohibited transaction under ERISA. Fortunately, the DOL also issued an exemption to this rule, Class Prohibited Transaction Exemption 2004-16, permitting a bank or other financial institution to select itself, or its affiliate, as the IRA provider for automatic rollovers from its own retirement plans. The exemption also allows a bank (or other such institution) to choose its own funds or investment products for the investment of automatic rollovers. However, it is important to be aware that, while the institution may charge fees for establishing the IRA consistent with the regulation, ongoing fees are limited to the amount of income earned by the IRA (i.e., the general restriction that was dropped from the regulation applies in this situation).

Essentially, this exemption means that IRA providers are not required to use their competitors to service their own retirement plans' automatic rollovers.

Implications for Plan Sponsors

From a plan sponsor perspective, it will become increasingly common to consider whether a potential trustee's retail side provides these automatic rollover IRAs as part of its services. This will likely be an additional consideration by the plan sponsor as it reviews the suite of services an institution offers when selecting a trustee. With specific regard to JPMorgan Chase, our Retirement Plan Services Group is currently in the process of conducting a strategic review to determine the viability of supporting automatic rollover IRAs. We will keep you informed of product availability in this area.

As Yet Unresolved

Some financial institutions have raised the concern that under some states' laws, the account holder is required to sign an account document opening the account. The DOL noted that it did not have authority to address this issue. On the other hand, customer identification programs (CIP) under the U.S. Patriot Act don't apply to these types of accounts until the individual actually exerts control over the account. In short, the financial institution is not required to pursue CIP procedures when the plan sponsor opens the account for the participant. Instead, it is required to pursue CIP procedures only once the participant contacts the institution to request a withdrawal or to change the investment vehicle.

Long-Awaited Clarification Regarding Missing Plan Participants

What does a plan fiduciary need to do in order to fulfill its obligations under ERISA with respect to locating a missing participant of a terminated defined contribution plan when efforts to communicate with a missing participant fail to secure a distribution election? Previously, with no guidance from the DOL, fiduciaries were truly wedged between a rock and a hard place when it came to locating missing participants.

Right on the heels of the final DOL regulations regarding the safe harbor for automatic rollovers comes the recent clarification — long-awaited and most welcomed — and guidance from the DOL regarding locating missing plan participants. For the first time, the DOL has issued a structured approach for plan sponsors along with distribution guidance in order to get a plan liquidated and effectively terminated.

Four Necessary Search Methods Outlined

While the guidance itself outlines requirements for fiduciaries and their responsibility to act prudently and solely in the interest of the plan's participants and beneficiaries, the guidance boils down to four mandated steps that a fiduciary must follow in an effort to locate a missing participant or beneficiary before the fiduciary determines that the participant cannot be found and distributes his or her benefits in accordance with other DOL guidance. It is important to note that a plan fiduciary is not obligated to take each of these steps if one or more of them are successful in locating the missing participant. These methods are:

1. Use Certified Mail. A cost effective method, certified mail can be used to ascertain whether the participant can be reached in order to distribute benefits.

2. Check Related Plan Records. While the records of the terminated plan may not have current address information, it is possible that the employer or another plan of the employer, such as a group health plan, may have more up-to-date information. For this reason, plan fiduciaries of the terminated plan must contact both the employer and administrator(s) of related plans to search their records for a more current address for the missing participant.

3. Check with Designated Plan Beneficiary. Plan fiduciaries must try to identify and contact any individual that the missing participant has designated as a beneficiary. If there are privacy concerns, the fiduciary can request the beneficiary to contact or forward a letter to the participant, requesting contact.

4. Use a Letter Forwarding Service. Both the IRS and the Social Security Administration (SSA) offer letter-forwarding services. Plan fiduciaries must choose one and use it in an attempt to locate the missing participant. Helpfully, the DOL stated that the plan fiduciary may set a deadline by which the participant must respond when this method is used.

What if these methods fail? Plan sponsors are then asked to consider additional search options, such as internet search tools or commercial locator services. The plan sponsor can ultimately charge the cost of these additional serv-

ices to the participant's account, provided it has complied with earlier DOL guidance on allocating expenses to participants (such as disclosure to participants that such an expense would be charged), and provided the size of the account balance is considered relative to the cost to be charged. If the account balance is small, the plan sponsor may decide to dispense with this step.

Once all required search options are exhausted and the missing participant cannot be found, the most favored default option under this guidance is a rollover to an IRA. For terminating defined contribution plans, the DOL has determined that the safe harbor rules described above can be used for account balances over \$5,000.

Escheat Now an Option

If the fiduciary cannot find an institution that is willing to accept a rollover IRA, and there is no other defined contribution plan of the sponsor to which the participant's account can be transferred, there are two alternatives. One is a federally insured bank account, and the other — which is truly a sea change for the DOL — is to escheat the funds to a state unclaimed property fund. This is a huge departure from the DOL's previous position, which prohibited escheat under any circumstances. Now, transferring the missing participant's account balance from a terminated DC plan to either such a bank account or an unclaimed property fund is considered a plan distribution, thereby ending both the property owner's status as a plan participant and the property's status as plan assets under ERISA.

In deciding between a federally insured bank account and a state unclaimed property fund, fiduciaries are asked to consider or evaluate any interest accrual fees associated with a bank account against the availability of the state unclaimed property fund's searchable database that may facilitate the potential for recovery. In any event, transfer of the funds to state unclaimed property funds must comply with state law requirements. This is practical and useful guidance that is welcome news for plan sponsors and their institutional trustees.

More to Come

The Department of Labor has indicated that a third piece of guidance for institutional trustees on dealing with abandoned plans will be forthcoming. ○○○

JPMorgan Chase Bank and its affiliates do not render tax or legal advice. For tax or legal advice specific to your situation, please consult your tax advisor or attorney.

regulation:

will europe's financial services action plan succeed?



By Sheenagh Gordon-Hart, head of Strategy, Research and Government Affairs, JPMorgan Investor Services, Europe, Middle East & Africa (EMEA)

Sheenagh Gordon-Hart joined JPMorgan in 2001 as head of Strategy and Research for the Investor Services Division, EMEA and has responsibility for Government Affairs. She has an MA in Political Science and Law, and is a Chartered Accountant.

2004 saw an historic enlargement of the European Union (EU) and progress toward the final stages of the Financial Services Action Plan (FSAP). The jury is still out on both developments — their impact will be emergent rather than immediate. However, what is clear, is that the EU certainly has no lack of ambition.

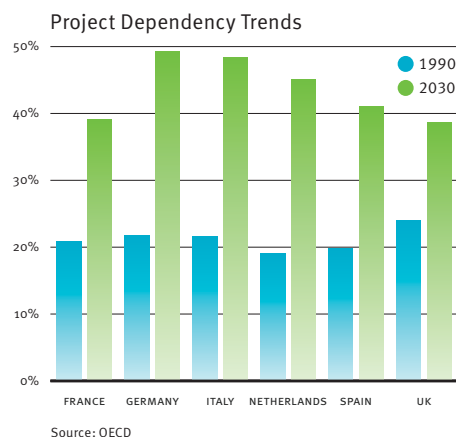
The FSAP was set out in May 1999, with the objective of achieving an integrated EU capital market by April 2004 — a lofty aim. And whilst it is in the final stages of completion, many aspects will need to be revisited as more shortcomings reveal themselves. The underlying aims of FSAP include: achieving a single financial services market, ensuring openness and security in retail markets, and providing state-of-the-art prudential rules and supervision.

Whilst the introduction of the euro was an important element in facilitating radical change by eliminating exchange rate risk, its impact on, for example, the euro-denominated bond market, was more muted than was expected. The market downturn served to bring an end to early positive signs of growth of the equity markets. Certainly a Europe-wide approach, such as that envisaged by FSAP is essential, but with 42 directives and a timetable set somewhat arbitrarily by politicians, successful outcomes are by no means guaranteed. Indeed, the FSAP is throwing into 'sharp relief' the vast differences in business practices and cultures across Europe. The problems being encountered prompted the following quote from Callum McCarthy, then the relatively new Chairman of the U.K.'s Financial Services Authority: "A series of looming bottlenecks threatens to derail the effective implementation of the EU's FSAP".¹

The achievement of a single market is of critical importance for a number of reasons. The *Heinemann Report*,² commissioned by the U.K.'s Investment Management Association, for example, estimated that a single market for asset management in Europe would release €5 billion *per annum* in material

economic benefits, sufficient to increase the value of the average investor's pension by 9% or €120,000. In 2002, a study by London Economics (one of Europe's leading specialist economic consultancies) estimated that FSAP as a whole would increase Europe-wide GDP by €130 billion. As the biggest challenges facing the EU in the medium term are a rapidly aging population³ twinned with a vast savings gap, achievement of a single market for asset management in the context of the broader based FSAP is vital. However, how it is to be achieved is the subject of debate and there would appear to be severe shortcomings in some aspects of the current European approach to new regulation.

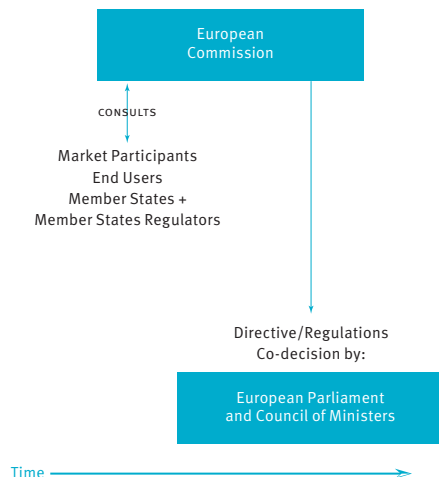
For most people, Europe is acknowledged to be of great importance; however, the processes behind the scenes, and even the



1. "Action Needed to Overcome Implementation Threat to EU Financial Reforms," October 2003.

2. Heinemann, et al, "Towards a Single European Market in Asset Management," *Zentrum für Europäische Wirtschaftsforschung*, 2003.

3. In Europe, fertility declined in the 1970s to 1.7 against a replacement rate of 2.1, while longevity increased from 67 in 1960 to 75 in 2000.

Level 1 Proposal

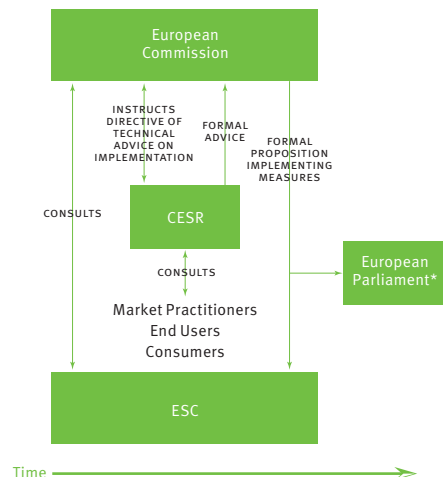
‘actors on the stage’ are not necessarily well understood. The chart below shows the road map for Levels 1 and 2 of the Lamfalussy process which Europe’s financial services market place is subject to.

This process is a four-level approach proposed initially by the “Committee of Wise Men,” (chaired by Baron Alexandre Lamfalussy) in February 2001 and designed to address some of the perceived shortcomings in European securities regulation. Whilst it has immense logic, and there has been some measurable achievement, it is by no means obvious that this is other than a step towards a more integrated approach. There are serious question marks on the enforcement front and there is some evidence that new regulation aimed at ‘harmonisation’ actually ends up promoting both greater protectionism and the creation of more imaginatively constructed barriers. Certainly, Lamfalussy has set out a framework, but the demands being placed on market participants, regulators and other interested parties by the EU’s ambitious plans are burdensome and increasingly costly.

JPMorgan, in common with other large financial institutions in Europe and around the world, has a heavy regulatory agenda. Every aspect of the FSAP affects the firm

Level 2 Proposal

Technical Implementing Measures of
Level 1 Directives/Regulators



* European Parliament is given one month to consider if Level 2 measures approved by ESC should be adopted by the Commission

and its clients either directly or indirectly. Not all regulation is good regulation and we in JPMorgan Investor Services aim to play a full part in identifying threats and opportunities that present themselves with the ever burgeoning rule books.

Taxation of Savings Directive

Another regulatory area that we have focused on over the past year is the EU Taxation of Savings Directive (EUSD). Its history has been unfolding over many years, but at its root it aims to curb opportunities for tax evasion by individuals who invest in savings accounts, securities and funds in jurisdictions other than where they reside. Evasion is a major problem in many parts of Europe and usually reflects a thriving “black economy” (the informal or unofficial economy of a country which includes undeclared earnings and enjoyment of undervalued goods and services designed for tax evasion purposes), twinned with high personal tax rates. For example, the black economies of Greece and Italy are estimated to be in excess of 25% of GDP. Whereas in the U.S., the black economy is estimated at only 8% of GDP.

The problem of evasion in Europe is widespread; German citizens are estimated to have in excess of €300 billion invested ‘offshore’, whilst the equivalent figure for

Italians is €200 billion. Benchmarking undeclared investments and other holdings is fraught with difficulty, but Switzerland alone (and it is by no means the only ‘safe haven’ for privacy) has €1.2 trillion in bank accounts held by non-residents.

So, the EUSD was introduced with a view toward eliminating opportunities for tax fraud. The concept seems simple enough and implementation would have been more straightforward if Europe existed in its own vacuum. However, the problems associated with this Directive largely stem from extraneous factors.

Probably, the most important issue that has hindered the introduction of the Directive, and certainly has been the cause of delay in implementation,⁴ concerns the position of third countries, notably Switzerland, that pose a significant competitive threat. Switzerland had to be persuaded to sign up, at least in part, for the Directive by way of bi-lateral Treaty to enable the Directive of having any hope of succeeding inside the EU. Switzerland has now declared that it will be ready to adopt similar provisions to those established under EUSD on July 1, 2005 and hence there is unlikely to be any further delay.

Of course, the third countries required to sign up for the Directive do not comprise an exhaustive list. This in itself is a weakness. In the main, the third countries are those with close geographic or other ties to Europe or its member states, for example British dependencies. However, geography may not be a strong point at the EU — they omitted to include Bermuda, perhaps not realising that it is not in the Caribbean.

It may be worth explaining, albeit briefly, what the Directive covers. In essence, the Directive is aimed at EU cross-border payments of interest to individuals. Thus, in the first instance, there is a requirement to define what interest is — and there are instruments that it would appear should

4. Originally, the Directive was due to be implemented on January 1, 2005. It is currently expected to be implemented on July 1, 2005.

Lamfalussy: A Four-Level Approach

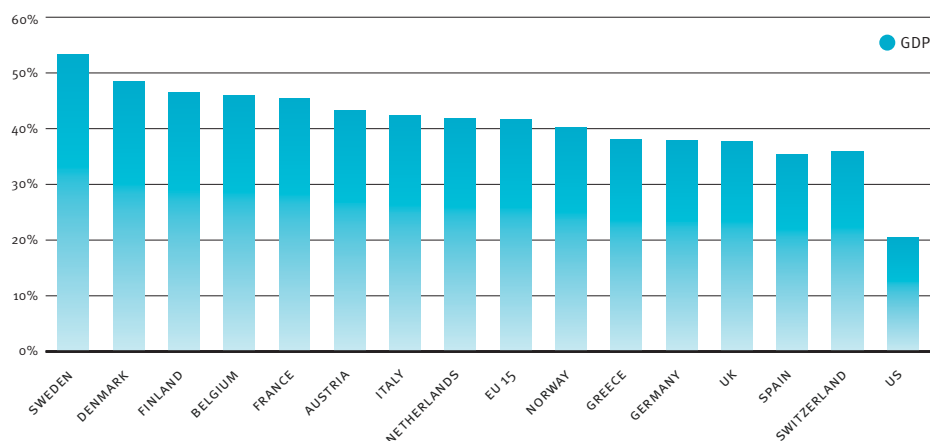
- ▶ **Level 1:** High level objectives that legislation must achieve
- ▶ **Level 2:** Defines the technical requirements necessary to achieve objectives
- ▶ **Level 3:** Provides for common and uniform implementation by, for example, providing common interpretation and guidance
- ▶ **Level 4:** Relates to enforcement

be included but that are excluded under grandfathering provisions. In addition, it seems that Switzerland for its part in signing up to EUSD has excluded income from Swiss bonds, amongst other things.

Other areas where there remain uncertainties include the treatment of funds of funds. There is intense lobbying in Luxembourg to have funds of funds excluded, but this would create a massive loophole and surely undermine the entire EUSD project. This and many other differences in interpretation have added to the frustration and cost of those institutions like JPMorgan that seek to provide scaleable pan-European solutions to clients.

Tax Burden Chart

Tax burden as a percentage of GDP in the USA and Europe, 1999



Source: OECD

The EUSD seeks to place responsibility for withholding tax or exchanging of information on the paying agent (defined as 'final economic operator'). This is proving to be less than satisfactory and will doubtlessly give rise to problems once the Directive is implemented, because the 'paying agent' is not the paying agent as normally understood. It has certainly required all fund groups to audit and categorise their product and client bases to establish whether the EUSD has application, overhaul KYC procedures, amend application forms, etc.

In essence, Europe will operate two parallel approaches to EUSD. The first is exchange of information, the approach finally adopted by all EU member states except Belgium, Austria and Luxembourg. In the case of the latter three states, withholding tax will be 'the norm' unless investors opt for information exchange or supply a certificate from the tax authorities in their own jurisdiction that certifies they may receive income gross. The reason given for the adoption of a different approach was explained as follows: 'In view of structural

differences, Austria, Belgium and Luxembourg cannot apply the automatic exchange of information at the same time as the other member states.' It is intended that the withholding regime should have a limited life but it is generally agreed that unless Switzerland and Luxembourg together agree to abandon bank secrecy, the régime will have an indefinite life. EUSD certainly has laudable aims — it remains to be seen if it can be hailed a success in the end. One of the U.K.'s commonly voiced criticisms of the EU's legislative and regulatory agenda is that new initiatives are not subject to cost benefit analysis — imposing such a discipline on the EUSD may not have derailed the Directive completely, but it may

have led to better-drafted legislation with a better chance of success.

More Regulations in 2005

What else is in the European regulatory pipeline for 2005 and beyond? There are some major projects in production: Basel II (under the auspices of capital adequacy in Europe); International Accounting Standards (IAS); and Investment Services Directive reform (ISD2) under the new title of the Markets in Financial Instruments Directive, to name just three.

Basel II, drafted by and aimed at bankers, has a much broader application in Europe, with investment firms also covered along with securities dealers and others in the Risk-Based Capital Directive (CAD II). Much remains to be discussed in the fine-tuning of CAD II to European requirements — almost certainly there will be difficulties in implementation and opportunities for regulatory arbitrage will emerge. Meanwhile, the Committee of European Banking Supervisors (CEBS) has set up a consultative panel of representa-

tives of market participants and end-users to support its work on implementation of the revised capital adequacy rules.

IAS is a key area where the ambition is commendable but the growing pains may last for some considerable time. From 1 January 2005, more than 7,000 listed companies will adopt the standards. The aim — to achieve more transparency and comparability for investors and hence promote efficiency in the capital markets — is to be welcomed, but as with all big picture efforts, political obstacles have abounded, compromises and carve-outs made (on IAS 39 — treatment of derivatives); convergence with U.S. GAAP, whilst desirable, will not be achieved in this step. The impact of IAS will be much more significant for countries such as France and Germany for example, than for the U.K. and Ireland. The intention remains to reduce the requirement for reconciliation of accounts between FASB and IASB standards by 2007. Whether this will be achievable is debatable because there is significant strain between what is perceived to be the prescriptive rules-based approach adopted by the English speaking world, particularly in the U.K. and U.S., and the more principles-based approach favoured by Continental Europeans. All in all, however, International Accounting Standards, adopted in full by around 70 countries outside the EU, and in part by the EU, will be a major achievement.

The ISD II has led to significant differences of opinion, particularly concerning pre-trade transparency and best execution. Regulators hope to provide their implementation guidance in early 2005, but it is not at all clear that the outcome will be satisfactory.

Further, work continues to clarify and provide implementation guidelines under UCITS III. Many groups are concerned that UCITS III may prove to be a backward step rather than a long-awaited leap forward. The jury is out, but expect UCITS III to be the centre of some heated debate during 2005.

The question remains... How much closer is Europe getting to a single market? On 6 December 2004, CESR⁵ hosted a conference in Paris entitled 'Europe's Single Market: Under construction or fully integrated?' The answer could be... 'trying hard, could do much better'. ○○○

5. Committee of European Securities Regulators.

china's regulations offer first time opportunities

“While it is difficult to predict the ultimate impact these regulatory changes might have on China’s market, we do anticipate that continued relaxation of restrictions is likely.”

Large amounts of inbound investment, speculative funds and trade surpluses have raised China’s foreign-exchange reserves to \$483 billion as of mid-2004. As a result, China has recently announced rules to make it easier for Chinese companies to invest overseas and expand internationally. “Even though China is the world’s largest recipient of direct foreign investment, the amount invested by Chinese companies abroad is comparatively small,” says Steve McCullough, business manager Asia Ex Japan/Australia, JPMorgan Investor Services, Asia Pacific (APAC). However, the recent regulatory developments are expected to change that.

“Until recently, access to China’s capital markets was limited to only a few options,” says McCullough. “In the past, investors mainly had access through Red Chips in Hong Kong (China-controlled firms with mainland assets), or the B share market in the Shenzhen Stock Exchange (SZSE) and the Shanghai Stock Exchange (SHSE),” he says. In addition, the creation of the QFII (Qualified Foreign Institutional Investors), allowed foreign investors access to the Chinese A share and debt markets for the first time. As of November 2004, China had approved 21 QFII investors, at a total investment limit of \$3 billion.

China’s Investment Options Expand

However, more recently, China’s investment menu has expanded to include not only investment into China, but also QDII investors (Qualified Domestic Institutional Investor), which allows China’s institutional investors to invest in offshore markets for the first time. “There was much speculation in the press around this issue,” McCullough says. “Some thought that China’s National Social Security Fund

would be the first institution to invest overseas,” he says. However, it was China’s insurance companies that were initially approved under the *Temporary Measures on*

*Overseas Use of Foreign Exchange Funds Regulation*¹ issued by the Chinese Insurance Regulatory Commission (CIRC) and the State Authority for Foreign Exchange (SAFE).

Custodians play an important role in this new regulation. “QDII status for Chinese insurance companies will likely result in opportunities for global custodians and our clients; providing opportunities for assets to be held in global pools in multiple jurisdictions and segregated portfolio management,” McCullough explains.

Chinese officials have drafted the regulations to ensure that the assets and records of investment activity by insurance company clients are retained and available to them. As a result, the insurer’s domestic custodian is required to hold a local domestic custody license and, on a

1. Foreign exchange funds refers to the aggregate capital, common reserves, undistributed profits and guaranteed deposits, received by an insurance company that are denominated in foreign exchange.

regular basis, to report on the overseas investment activities of the insurance company to both the CIRC and SAFE on the remittance of capital to and from China.

“We believe this particular requirement only relates to the investment activities of the insurance companies in line with their investment objectives and not a broader requirement to police their general activities,” says McCullough. The regulators, however, are very interested in learning about the role of a trustee and as a result we will discuss the activities of JPMorgan in other locations where the trustee function is embedded within the market structure, such as in the U.K.

Under the new regulations, the insurance segment is permitted to invest up to \$9 billion in overseas assets. “The decision was largely driven by the successful overseas listing of Chinese insurance companies in the U.S. and Hong Kong,” McCullough explains. Those companies include: China Life Insurance Co., PICC Property & Casualty Co. (China’s largest general insurer), and Ping An Insurance Group Company of China. Further scope was built into the regulations to allow Sino-foreign joint ventures or a branch of a foreign insurance company approved by the CIRC.

China’s Insurance Companies Must Meet Certain Criteria Before Being Permitted to Invest Offshore:

1. Must have a permit for conducting foreign exchange business;
2. The company’s total assets at the end of the previous year must not be less than rmb 5 billion;
3. Foreign exchange funds at the end of the previous year must not be less than \$15 million or equivalent value in a freely convertible currency;
4. The company’s solvency margin complies with relevant stipulations of the CIRC;
5. The company has a specialized fund use department or a relevant insurance asset management company;
6. Internal management and risk control systems must comply with the stipulations of the risk control guidelines for use of insurance funds;
7. The number of professional managerial personnel with over 2 years’ overseas investment experience must comply with relevant stipulations; and
8. Other qualifications specified by the CIRC and the SAFE.

Requirements for Overseas Investment Institutions:

1. A company will be permitted to conduct asset management business according to the law of the country or region where it is located;
2. A company’s risk control indexes shall comply with the law of the country or region where it is located and with relevant regulations of its supervisory authority;
3. Neither the company’s paid-up capital nor its net assets shall be less than \$60 million or equivalent value in a freely convertible currency. The amount of assets under its management shall not be less than \$50 billion or equivalent value in a freely convertible currency;
4. A company should have a sound corporate governance structure, a good and complete internal management system and a good and complete risk control mechanism with no record of serious violations of laws or regulations in the country or region where it is located in the last three years;
5. A company must have over 10 years of business experience in international asset management with a corresponding number of professional investment personnel;
6. A company shall make a written commitment to truthfully provide transaction information about overseas use of foreign exchange insurance funds as required by the CIRC when necessary;
7. The country or region where the company is located shall have a sound financial supervision system. Its financial supervisory authorities shall have signed memorandum of understanding for supervision cooperation with Chinese financial supervisory authorities and keep effective cooperative relationship in respect of supervision with their Chinese counterparts; and
8. Other requirements specified by the CIRC on the principle of prudence.

“It is tough to have two years of international investment experience when, until now, insurance companies have not been permitted to invest offshore”

According to McCullough, insurance companies have been establishing asset management companies to support their own investment activities and may also eventually be allowed to manage assets on behalf of other insurance companies as well. “Additional regulations have also been passed permitting the insurance companies themselves to invest directly into the domestic capital markets, where in the past, they were limited to mutual funds and bank deposits,” McCullough adds. In addition to increased market liquidity, the regulations offer China’s insurance companies the opportunity for further diversification and the potential for increased returns.

Insurance Companies Invest Offshore

Under the new regulations, insurance companies are permitted to appoint overseas institutions to act as investment managers. Given the regulations’ requirement that professional managers must have over two years of investment experience, there could be significant opportunity for separately managed portfolios. “Because the market has been closed, experience levels in the industry are relatively low. It is tough to have two years of international investment experience when, until now, insurance companies have not been permitted to invest offshore,” he says. Interestingly, resumes of such staff are required to be submitted to the regulators as part of the application process.

The investment scope, if released as expected, will be fairly restricted and limited to:

- ▶ Bank² deposits; bonds of foreign governments, international financial organizations;
- ▶ Foreign companies’ bonds³ that the Chinese government or Chinese enterprises issue overseas;
- ▶ Money market⁴ products including bank bills and negotiable certificates of deposit; and other investment objects and instruments within the scope specified by the state council.

McCullough says, “While it is difficult to predict the ultimate impact this regulatory change might have on China’s market, we do anticipate that continued relaxation of restrictions is likely. With further investment flows out of China through the gradual roll out of QDII mechanism, the amount of offshore insurance assets should likely double within the next one to two years. We look forward to supporting this new and exciting segment and to continue to play a supporting role to regulators and market participants alike.” ○○○

Currently, there are three JPMorgan Chase bank branches in China, in Beijing, Tienjian and Shanghai. For more information on investing in China, contact Steve McCullough at (852) 28001800.

2. “Bank” refers to an overseas branch of a Chinese commercial bank or a foreign bank with long-term credit rating of “A” or above granted by an internationally recognized rating institution in the past three years.

3. Bonds refer to the bonds with credit rating of “A” or above granted by an internationally recognized rating institution.

4. Money market products refers to money market products with regular earnings and a AAA rating or equivalent granted by an internationally recognized rating institution.

forging the future one market at a time

securities lending
builds its presence
in asia

After enjoying a period of rapid acceleration in the late 1980s and early 1990s, lack of activity and continuing regulations from local governments seemed to have slowed the pace of growth for securities lending within the Asia Pacific region (APAC). However, interest and activity seem to have recently re-ignited as select markets begin to show signs of making progress toward an organized lending structure.

While regulations continue to restrict certain aspects of lending in countries such as Malaysia and Thailand, other Asia-region countries such as Hong Kong, Japan, Singapore and Korea are increasingly looking to securities lending. Whether due to increased pressure on asset managers to improve returns, continued globalization, or the natural evolution of growing markets, securities lending is doubtlessly continuing to evolve as a valuable component of both a sound and flexible investment strategy, and a developed marketplace.

Pioneering a Presence for Decades

JPMorgan has long recognized the rich potential of the APAC region. Lending securities for over 20 years, the firm

continues to build a local presence in Asia on a market-by-market basis. With its first office in Australia established in 1872, and operations in Hong Kong since the 1920s, today JPMorgan continues to expand its global reach in the region, supported by a truly local footprint. The firm has more than 6,500 employees in the region located in 24 offices in 15 countries, with the firm's Investment Bank, Treasury & Securities Services, Asset & Wealth Management, JPMorgan Partners and Global Treasury businesses particularly active.

From a securities lending perspective, JPMorgan Investor Services was a leader in taking a visionary view of the APAC markets. Its first lending activity in the region was in 1987 in Japan, well ahead of many of its competitors. Its recent pioneering activities in Taiwan and Korea serve to further embody the firm's role as an industry leader. In 2002, JPMorgan Information Services became the first agent lender to enter Korea, and in 2003, was the first to establish a synthetic lending structure in Taiwan for off-shore lenders.

Due Diligence is Key

Among the major considerations when entering into a new lending market is the due diligence necessary to determine if there is, in fact, demand for securities lending. An equally rigorous exploration of both regulations and counter-parties then follows and is vital to determining appropriate demand.

"There are certain elements that make markets desirable from a lending perspective," says David Brown, Securities Lending and Investment Products business executive, JPMorgan Investor Services Asia Pacific. "You want to see a degree of liquidity, as well as healthy levels of corporate activity, such as mergers and acquisitions, and convertible bond issuance." Additionally, favorable conditions must converge with other factors to make for a lending-friendly backdrop. "Demand must come together with the market itself recognizing that lending is desirable," Brown adds. Other factors include hedge funds recognizing opportunities in those markets, prime brokers looking to support those hedge funds, and available lenders like JPMorgan, who have the necessary supply of stock to lend on behalf of their clients, looking to go into those markets.

The local regulatory environment in many of APAC's markets is an especially important and often challenging factor as well. Local taxes, for example, can make lending transactions essentially uneconomic. "In some countries it's perfectly legal to lend, but taxes on transactions themselves, or on certain entitlements, together with increased operational burdens imposed on lending can make it unattractive," Brown says. Regulations can sometimes eliminate a market from the lineup of eligible countries. Perhaps the most important aspect of thorough due diligence in the region rests in terms of evaluating eligible counter-parties. "The importance of this cannot be overemphasized," says Avi Stein, Securities Lending and

revolved around the inadmissibility of a traditional lending structure, in that stock could not be delivered free of payment. However, by utilizing an innovative approach JPMorgan was able to gain approval for a non-standard product that facilitated a stock loan trade, placing Investor Services on the cutting edge of this new market.

"Markets that wish to be seen as forward-looking and progressive, and those that seek to put better practices in place, understand that it is important to offer securities lending," Lee explains. Most important, he says, securities lending in itself helps markets evolve and become more liquid and flexible, mainly by facilitating certain trading strategies and providing liquidity to the markets.

"Regulations can sometimes wind up actually eliminating a market from the lineup of eligible countries."



Investment Products global business executive, JPMorgan Investor Services. Referring to the JPMorgan Investor Services' new Securities Lending venture in Taiwan, Stein explains, "We stress this point as much as we emphasize our excitement and comfort with the structure we've developed there, which helps to assure full, extensive due diligence with respect to counter-parties."

Stein emphasizes that clients should examine all aspects of a lending agent's due diligence operations in Asia before engaging in lending. "In markets such as Taiwan, where there is no formal lending structure in place for offshore participants, lenders have an even greater onus to determine that meticulous due diligence has been performed in regard to counter-parties," agrees Michelle Phillips, global head of trading, JPMorgan Investor Services. "Because our primary structure in Taiwan is a synthetic one, completely proprietary to JPMorgan, we offer the comfort of knowing that our firm is behind every loan, indemnifying the client against broker default, and backed by the extensive due diligence of any and all counter-parties that we perform."

First to Market in Korea

Despite the challenges and even obstacles to lending in select APAC markets, ingenuity and innovation can lead to client-focused solutions and actually overcome many of the barriers to lending. One of the most recent examples of that innovation lies in Korea, where JPMorgan was the first agent lender to enter that country's market in 2001.

"The Korean marketplace represented a lucrative opportunity for us," says Simon Lee, vice president Securities Lending, JPMorgan Investor Services Asia Pacific. "The high demand from hedge funds to borrow Korean equities to facilitate trading strategies, combined with limited supply, created significant opportunities for our clients."

Gaining approval for lending, however, was not accomplished without having to overcome some of the obstacles previously mentioned, the most notable of which

"For those markets that want to be players on the world stage and attract significant capital, an active securities lending arena is a virtual necessity," he says.

The Korean lending market has also proven to be an interesting case study of how a new market evolves. The early days of the market were notable for the lack of supply and the correspondingly high spreads. As time has passed, more participants have come to the market on both the lending and borrowing side of the business, and a degree of equilibrium has recently been in evidence. Lee adds that conditions currently point to favorable momentum as demand remains strong, despite greater liquidity (and therefore thinner spreads) of late. "The injection of supply through recent entrants to market in Korea — following JPMorgan's lead — allow us to manage our program, continuing to take great care in the prudent management of our clients' securities," explains Lee. Stein agrees, "We generally take a strategic approach when liquidity increases in markets, viewing it as an opportunity to make changes to our policies in order to further maximize opportunities and, ultimately, increase client income while shrewdly managing risk."

Taiwan Follows Suit

After witnessing Korea's successful entree into securities lending, Lee says that Taiwanese authorities looked to follow suit, and in 2003 moved to create an active lending market.

On June 30, 2003, the Taiwanese Securities and Futures Commission opened its door to Qualified Foreign Institutional Investors (QFIIs), permitting them to participate in the Taiwan Stock Exchange's (TSE) borrowing and lending system. While the breakthrough was regarded by many as a hopeful sign of increased global opportunities for lending, some industry participants believed that due to the previously restrictive nature of the TSE, it would be a while before a full-fledged securities lending program was up and running. In any case, it was clear that wide-

spread participation in Taiwan would require clarification of the current framework, fine-tuning, and in some cases revisions, particularly in regard to the treatment of corporate action entitlements, 'purpose' tests for loan eligibility and collateral requirements.

While the introduction of lending to a new market is not an immediate process in any of the world's regions, Taiwan, admittedly, worked swiftly to make lending a possibility. "To its credit," says Brown, "Taiwan moved very quickly compared to other markets. It has evolved from strictly local securities lending as recently as 2003. This allowed us to offer a loan-type product to our clients who want to borrow in the region."

Initially, Taiwan offered simply an on-shore lending market with all the attendant elements of the business in place. Still today, the Taiwanese lending market has a distinctively on-shore feel; Taiwanese-denominated collateral must be maintained on shore, and there are the usual local regulations, taxes and other legalities to consider. Only local participants, Taiwan-based brokerage houses and investors, and QFIIs are allowed to execute trades within the market. Lee explains, "Certain regulations mean that lending in Taiwan will not suit every investor." This includes strict regulations surrounding fails. "But for those clients who are alert to the additional requirements, there is the potential to realize material rewards," he says.

However, Lee points out that the existing market did allow JPMorgan Investor Services Securities Lending team to work with its borrowers to develop a synthetic lending structure, thereby creating a solution for clients who

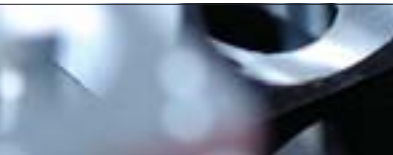
make it more acceptable to traditionally conservative lending clients. "Those clients who are extremely well-informed in regard to the lending arena," says Shellard, "and who are prepared to commit the time and effort involved in executing this type of transaction, stand to profit from this new and potentially lucrative opportunity."

"We have invested a substantial amount of time, money and research in developing a synthetic structure that is proprietary to JPMorgan Securities Lending in Taiwan," says Brown. Conducting a thorough assessment of eligible counter-parties is a major component of this effort. "This is essential to help protect our clients," he says, "and to help assure that clients who can work within our approved structure will have access to excellent potential income opportunities."

Stein adds, "What's exciting is that Taiwan represents a market in great demand right now due to a limited supply and a finite number of players with a viable structure in place." Another positive sign is the relative speed at which the TSE has moved to implement the current framework, perhaps driven by the success of what Korea achieved, which should auger well for the future.

"Whether it's looking at expansion into new markets in APAC, or adding new lenders in the region," Phillips says, "there are numerous growth opportunities in APAC, all of which form part of JPMorgan's strategic aims for the global securities lending business."

Lee sums up the securities lending environment in the region best, "Securities lending has been an accepted practice in the U.S. and Europe for some time now, and



Major institutional investors in the region who aren't lending are asking themselves, "why not?"

wanted to participate in the Taiwanese market outside of the onshore regime.

Essentially, a structured trade within the synthetic product affords a client the benefits of a lending transaction without actually making a loan. "In Taiwan, as in most other markets, there is a requirement for traders to hedge positions, particularly in convertible bonds, warrants and futures, and the like," explains John Shellard, global head of Equity Lending, JPMorgan Investor Services Securities Lending. "This requires borrowing the underlying equity. The new structure allows JPMorgan's clients to lend the equity for the hedge in return for a fee, thereby generating significant incremental revenue for the client," he explains.

"It's effectively a derivative transaction, where you buy the derivative and then turn it into a loan, retaining the revenue benefits of lending," he says. The synthetic structure, he adds, combines elements of both the derivative transaction and a loan. The combination of the two significantly changes the risk profile of the transaction in an attempt to

now the Asia Pacific region is following suit. With the potential revenue opportunities, increasingly major institutional investors in the region who aren't lending are asking themselves, why not?"

JPMorgan Investor Services continues to be actively involved in the development of the APAC region, primarily through the Pan Asian Securities Lending Association (PASLA), an association of firms that are active in the business of borrowing and/or lending securities of Asian markets. Says Lee, "Innovation, strict due diligence measures and the increasingly receptive macro environment all point to a substantial profit potential for those clients willing to participate in these new markets." ○○○

For more information about JPMorgan Investor Services Securities Lending contact Gene Picone, global head of Securities Lending JPMorgan Investor Services, at (212) 623-2938, or your Client Service Officer or Relationship Manager.

it's 5pm: how much did you lose today on corporate actions?

By Neil Henderson, Securities Processing & Fund Services executive, JPMorgan Investor Services

With more than a million corporate actions taking place each year — valued in billions of dollars, pounds and euros — the poor quality and bulky flow of relevant information should have market participants waving their fists and threatening to sue. But until recently, the tolerance for loss in the corporate actions arena has been puzzling.

Even more perplexing, in a financial environment driven by sophisticated technology and instant communication, is that processing corporate actions continues to be largely manual — exposing everyone in a complex chain of intermediaries to considerable risk of failure.

Unlike the tree in the koan, corporate actions spring up overnight and a failure at any point in an event is unequivocally “heard” by hundreds of fund managers, custodians, broker/dealers and depositories — due to a single, undeniable dynamic: *the moment an issuer declares an event, the price of the underlying security changes.*

Clearly, the risk of failure is not just a back office issue, but also one that affects trading strategies and corporate positioning as well as the efficiency of the broader capital markets.

This article will provide an overview of the risks in the corporate action processing chain, and offer some insights into the solutions.

Neil Henderson is senior vice president and the Securities Processing and Fund Services executive for Investor Services. He is a member of the Euroclear Board, the SWIFT Board Securities Steering Committee, and the board of the International Securities Services Association (ISSA).

The Basics

Although there are more than a thousand types of corporate actions across international markets, for the most part they fall into the following three categories, each with its own potential for added expense, suboptimal trading decisions, and inefficient corporate governance.

- ▶ Compulsory Actions, such as cash dividend and interest payments, which require no discretionary action on the part of the investor/intermediaries;
- ▶ Compulsory Actions with Options, which, for example, may give shareholders the option to receive dividends as cash or as additional shares;
- ▶ Voluntary Actions, where an investment decision (and corresponding action) is required on the part of the investor/agents.

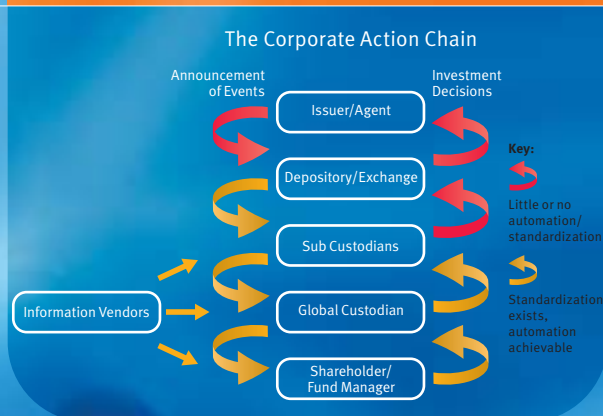
Although there is little operational risk in the first category, which requires no action, there is ample scope for failure in the second two, due to the following issues:

Confusing Notification: Issuers have a legal obligation to notify the market via prospectus and tombstone advertising; however, with no standard medium or format for making announcements, and no single securities identification system that is universally accepted, the only predictable results are confusion and uncertainty.

Multiple and Redundant Intermediaries: An entire sub-industry has grown up around scrubbing and interpreting the data from issuers, their agents and supplementary information vendors, encouraging understandably risk-averse fund managers to subscribe to multiple providers. As a result they are not only paying for redundant information, but also reducing a narrow decision window.

Incompatible Timeframes: With so many intermediaries setting their own deadlines for processing, handling and communicating, the window for the ultimate decision maker is often far too narrow.

“If a tree falls in the forest and nobody hears it, does it make a sound?” **Buddhist koan**



Lack of Standardization: A broad range of possible responses is complicated by regulatory and market-driven restrictions, as well as the need for cross border security. Standardizing forces a discipline around the process reduces errors and time loss, with end-to-end automation of corporate actions the ultimate goal.

Error Prone Communication: Instructions for high ticket, confidential investment decisions are often sent to investment intermediaries by fax, telex or unformatted email and processed manually — providing unlimited potential for misinterpretation or mishandling.

Conflicting Agendas: At the same time that financial institutions are working for standardization and straight through processing, corporate brokers are driven to invent complex variations for staging corporate events.

Complexity: A hostile takeover attempt, for example, can change form several times, and set off uncharted corporate actions on the part of the targeted corporation. With multiple rounds of updated information traveling up and down the chain of participants, the possibilities for error are exponentially increased and the cost of failure can be significant.

A recent study on the risks of corporate action processing by DTCC and Oxera Consulting,¹ suggests that losses due to poor investment decisions may be as high as \$8 billion. Clearly, the potential for error and miscommunication up and down the chain represents an unacceptable level of risk.

Working for Change

In an ideal world there would be no need to scrub corporate action data. Issuers would do their own interpretations, using industry approved standardized terms in industry standardized and machine readable formats — and the market would respond electronically, using industry approved communication channels with an end-to-end electronic audit trail. In the real world, of course, this kind of change tends to be evolutionary. The good news is the evolution is definitely in progress.

As recently as three years ago, corporate action information was still flowing via fax, mail and phone calls across 90 international markets, using varying formats, terms and standards, with manual input at every point in the chain. In the chilling words of an unhappy fund manager, “In the last year we processed more than \$400 million in corporate action investments entirely by fax.”

But in 2001, at the urging of its custodian members, SWIFT launched a new and more usable suite of messages for corporate actions; providing the first real opportunity for the entire industry to send and read comprehensive and consistent corporate action information. The current challenge is to get the industry to agree on standard terms, words, formatting and key data elements. In a very real sense, it means all of us must learn a new language. As we become more fluent as an industry, the goals of standardization and straight-through processing become more reachable.

1. “Corporate Action Processing: What are the Risks?” DTCC/Oxera 2004

corporate action instructions online

Furthermore, technology has arrived which enables issuers or their agents to announce the terms of a corporate action in a user-friendly way, and to convert to a machine readable ISO standard without the requirement for brand new software or hardware installations. The next real challenge will be encouraging the issuers and their agents to adopt such practices, and for established national market industry groups to provide the templates and mapping tables to support them.

The Pivotal Role of the Custodian

As a major global custodian and a leader in driving change, experience has taught us that solving our customer's problems helps us to help the industry. In terms of processing corporate actions, it means far more than capturing our clients' investment decisions and passing them on to the handling agents, it means laying the groundwork for change by developing effective, long-term solutions — solutions that can be adopted by other custodians, and ultimately become standard industry practice.

In this context, it meant being the first customer to utilize the SWIFT ISO15022 industry standard, and the first to use it for sending corporate action information. Today it means being a participant in industry market practice groups, actively helping to define standards in each market for each event

The Ongoing Evolution

The next steps must come from the issuers, who have much to gain through standardization. It will force a discipline around the entire process, which will reduce errors and time loss on their end as well as free up time and money for more value added uses. Becoming part of a joint effort will improve their standing in the markets, by eliminating everyone's reliance on old-fashioned publishing formats. No one can argue that it is much faster and more efficient to send data via a SWIFT ISO15022 message, than to print mail and email thousands of prospectuses all over the world.

JPMorgan's Corporate Action Instructions Online provides a user-friendly internet-based way to respond to corporate action information online. Corporate Action Instructions Online — accessible via JPMorgan ACCESSSM — helps clients reduce risk and improve operational efficiency by replacing phone- and fax-based systems.

This innovative corporate action tracking tool features:

- ▶ Delivery of corporate action notifications
- ▶ Internet access using single sign on and state-of-the-art security safeguards
- ▶ Easy inquiry via "fast search" function
- ▶ Ability to overwrite/amend pre-populated instruction data
- ▶ Ability to bulk instruct/respond
- ▶ Robust online instruction audit trails
- ▶ Red/amber/green deadline management

For more information contact your relationship manager or client service officer.

In the interim, at JPMorgan we encourage our clients to automate with us, either through SWIFT or our own corporate action internet portal. In addition, we offer clients innovative messaging solutions, enabling us to convert and deliver their information on Message Express (MX) in ISO15022 format. Our corporate action system receives information from daily automated vendor feeds, major market sources, as well as our extensive sub-custodian network, enabling us to provide timely and accurate information, aggressive response deadlines, and a comprehensive online suite of investor tools to allow for online reporting and instruction execution. The resulting STP rate of 60% for voluntary action instructions is clear evidence that these goals are truly achievable. ○○○

corporate governance and the proxy vote

The increased scrutiny of both regulators and special interest groups within the global investment community has resulted in increased regulation and strong pressure on fund managers to vote all meetings and publicise their votes and associated policies. This is well illustrated by the increased focus resulting from the passage in the U.S. of the Sarbanes Oxley Act of 2002,¹ and the Securities and Exchange Commission rules on proxy voting disclosure, which impacts U.S. registered investment companies and their subsidiaries, and by the recommendations laid out in Paul Myners' report to the Shareholder Voting Working Group² in the U.K. in February 2004.

By Ed Neeck, Network and Securities Processing Product Management executive, and Sheila Sommerville-Ford, Custody Product Management specialist, JPMorgan Investor Services

As a result of this pressure, global voting levels have increased significantly. Further, the demand to standardise and streamline inefficient global voting practices which affect shareholders' ability to efficiently exercise their right to vote continues to grow.

Today, JPMorgan processes approximately 400,000 global proxy voting ballot instructions from foreign institutional investors per year. Since 2003, there has been an increase of over 100% in the number of agendas generated and a 50% increase in the number of global ballots actually voted.

Because voting practices vary significantly by market, keeping abreast of rapidly evolving corporate governance practices and regulations is a challenge.

Barriers to voting — Share Blocking

Among the biggest frustrations for institutional investors is the requirement for share blocking: one of a number of areas currently under review in the recently published *European Commission Fostering an Appropriate Regime for Shareholders' Rights*.³ If a vote is cast, the share cannot typically be sold until the vote is either revoked or the meeting has taken place.

Since share blocking affects a security's liquidity, a fund must determine a policy on whether to vote at or refrain from voting at a meeting in order to keep the position liquid. Sometimes, the fund manager may decide that liquidity of the position outweighs the value of the vote and may choose not to vote in markets that operate a blocking practice.

An alternative mechanism used by issuers across some markets is a 'record date' system. The record date

provides a cut-off reconciliation date by which settled positions are eligible to participate in the meeting. The record date system is generally preferable to share blocking since it does not block the disposal of shares and guarantees a voting right on a given date, allowing the shareholder to sell or lend their securities. However, a record date can create conflict in markets that do not standardise the timing of a record date or set it too far in advance of the meeting.

Complications may arise in some countries where there is no recognition of a nominee or, there is a distinction between what types of actions a nominee may carry out. The nominee, for example, may be entitled to carry out all rights in regard to clearing and settlement, but may not have the administrative rights in regard to proxy voting. This would require a nominee to segregate client positions to achieve registration in the client's name to enable voting at the company meeting. In addition to segregating the assets, the beneficial owner may also be required to provide the sub custodian, who safe keeps the assets, with a power of attorney authorising the submission of the fund's votes. This process typically results in added end-to-end administrative burden.

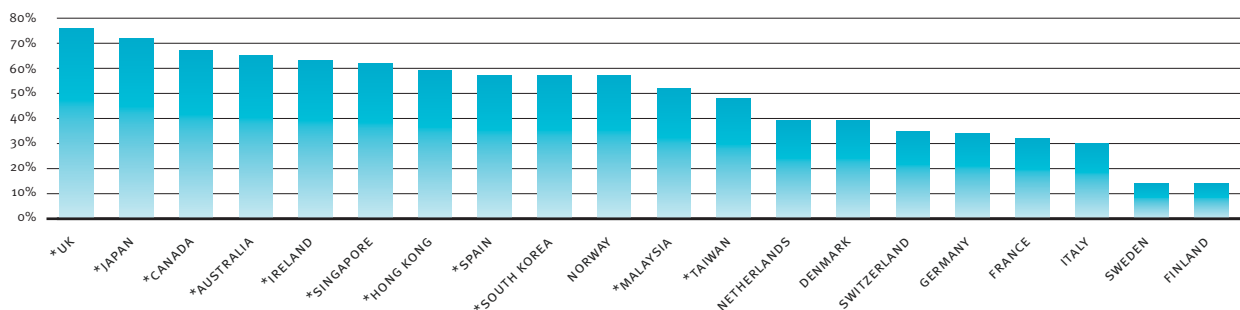
Keys to Improving Participation

Foreign investors are looking for a standard approach that simplifies the proxy voting process, helping reduce or eliminate the conflict between investment returns and corporate responsibility.

The following table notes the average ballot return rate for a selection of markets where JPMorgan offers global voting services. The table demonstrates that markets that offer a straightforward voting model without the need to block shares, register positions in beneficial owner name,



Percent of Ballots Voted Across a Selection



* Markets where there is no requirement to block shares or register in Beneficial Owner name to allow voting

or require Power of Attorneys and or personal representation at a meeting, typically see a much higher percentage of vote execution.

Improving Efficiency

Foreign institutional investors are looking for timely notification of meeting announcements, full disclosure of information and a mechanism to ensure that their vote is received by the company and counted at the meeting. Removal of paper based submissions of the proxy vote and the need for physical representation at meetings ideally facilitated through electronic voting are two of the most significant factors that could help create efficiencies and improve the voting process. Implementation of an electronic voting platform would reduce the risk of votes being lost and bring efficiency to the market through ease of access and improved confirmation of voting to investors across the world.

Electronic voting has been facilitated in the U.S. through the use of third party providers and is reasonably efficient. In the U.K. an example of an electronic voting platform that has been embraced by institutional investors and market participants is the model facilitated by CREST, the central depository. In the past year, more than 200 issuers in the various U.K. indices allowed voting through the platform and it is anticipated that issuer adoption will further increase over the next few years. In addition to facilitating automation and reduced use of paper, the platform also provides institutions and issuers with a much clearer audit trail of votes cast.

Keys to improving participation

In accordance with “best practices” employed around the world, sensible recommendations for increasing shareholder participation might be:

1. Standardise the time by which securities must be registered or shareholders disclosed in order to participate in a company meeting
2. Allow for safekeeping of securities in omnibus accounts with multiple registrations or the potential for separate disclosure
3. Recognition of intermediaries’ and custodians’ contractual relationships with their customers, without the need for powers of attorney
4. Removal of share blocking practices

Corporate Governance is a Responsibility

Good corporate governance is no longer an option but rather the responsibility of all market participants. The fiduciary importance and financial benefits of successfully and properly voting proxies is paramount in exercising shareholder rights. With 24-hour customer service, JPMorgan’s own Proxy Voting Service proactively serves the needs of institutional investors with a high quality cost-effective proxy voting solution, providing full online electronic voting capabilities that help institutional investors exercise their proxies and fulfill their increasingly expanding corporate governance responsibilities (see also *Thought* magazine, Q2/2004).

JPMorgan works both directly and indirectly with various market bodies to promote initiatives and processes that will allow greater participation at company meetings. Earlier this year the firm actively participated in the U.K. shareholder working practice group on the “Review of the Impediments to Voting U.K. Shares”, and more recently has worked with the Danish stock exchange raising some of the barriers foreign investors face in voting Danish securities in discussions with market participants.

By working directly on local market initiatives, or indirectly through international initiatives such as the ICGN,⁴ the firm believes the industry can collectively create a better environment for voting cross border securities. ○○○

For more information on proxy voting or JPMorgan’s Proxy Voting Service, contact your relationship manager or client service officer.

1. The Act, named after its primary architects, Senator Paul Sarbanes (D-Maryland) and Representative Michael Oxley (R-Ohio), is organised into eleven sections. These sections deal with such issues as auditor independence, corporate responsibility, enhanced financial disclosures, conflicts of interest, and corporate accountability, among other things.
2. In response to high profile cases of “lost votes” in the U.K. market, Paul Myners, a leading British reform advocate, was commissioned by the U.K. Shareholder voting Working group to perform a detailed review of the voting process.
3. The European Commission has launched a public consultation exercise of basic shareholders’ rights in company general meetings and solving problems in the cross-border exercise of such rights.
4. The International Corporate Governance Network (ICGN) is a leading authority in corporate governance.

any VIEW, any time...

the transformation of VIEWS

As the financial services industry continues to evolve, so does the amount and type of information clients require to run their businesses at the highest possible level. “Clients already know that we can offer the highest standard in core processing to include custody, accounting and related services. But what they want from us, beyond that, is the ability to interrogate our data, to slice and dice it, so that the diverse needs of their own operation are satisfied with a few clicks of the mouse,” says Neil Henderson, Securities Processing and Fund Services executive, JPMorgan Investor Services.

The rapidly changing regulatory environment is a good example of the kind of circumstances that have moved clients to increasingly demand improved real-time access and drill down capabilities to highly accurate data, to help them meet their reporting requirements. In response to that demand, JPMorgan Investor Services has developed a very flexible, comprehensive reporting suite... vital for clients conducting business in today's dynamic marketplace.

Significantly more than an upgrade, *enhanced* VIEWS is JPMorgan's already solid technology platform taken to the next level. This best-in-class information delivery solution has markedly expanded to provide clients with industry-leading reporting capabilities. “We believe the depth and range of the *enhanced* VIEWS platform is the most extensive offered in the industry,” says John Galante, Chief Technology Officer, JPMorgan Investor Services. “It covers the entire range of services that JPMorgan offers, and provides clients with whatever level of reporting they require, from simple repetitive reports, to advanced, deep, drill-down statements.”

Using state-of-the-art technology, this new data-centric hub provides clients access to industry-leading Accounting, Custody and Securities Lending reporting capabilities. Its simple and user-friendly interface offers clients intuitive navigation and links to JPMorgan's other

web-based applications including: Performance, Compliance, Browser Transaction Initiation, Network News and Reference and Corporate Action Instructions Online. In addition, *enhanced* VIEWS will replace all existing legacy reporting tools including VIEWS Reporting, Portfolio VIEWS and InfoStation Reporter. The single sign-on feature, through the JPMorgan ACCESSSM client portal, provides clients with any view, any time, with minimal clicks.

“Our clients each have different needs,” Henderson explains. “Some require relatively simple, repetitive every day reports, where others tend to be more sophisticated ‘power users’, demanding access to a wider range of data.” According to Henderson, these clients, generally very analytic in nature, often wish to produce highly customizable output and require tools that allow them to manipulate and interrogate that data for their specific needs. *Enhanced* VIEWS allows for both: the simple and the complex.

“We have access to a massive amount of data,” Galante adds. “What we've done is organize that data rationally across a whole range of products — Custody, Accounting, Compliance, Securities Lending, Performance Measurement and related products — and then given clients the tools to access the data and produce customized reports that are meaningful to them.”

The First View... Performance

VIEWS Performance, the first installment of the *enhanced* client reporting, VIEWS product suite, is currently being rolled out to Investor Services' Performance Measurement clients. Using the same multi-tiered technology structure as all of VIEWS' client reporting applications, JPMorgan has combined the strength of Investor Services' progressively focused intellectual capital and its in-depth industry expertise, with leading edge technology to produce VIEWS Performance.

VIEWS Performance provides clients with Performance Measurement reporting that is easily customized to meet both the most basic and the most sophisticated performance reporting requirements. Applying an advanced proprietary multifactor model, integrated into VIEWS Performance is one of the most comprehensive, separate account, investment manager and mutual fund data-bases available in the marketplace. In addition, it

“Enhanced VIEWS is JPMorgan's already solid technology platform taken to the next level.”

features performance attribution, security level analytics, as well as risk measurement reporting, allowing clients to assess risk and style, as well as the value added to investment accounts and/or funds.

“There are a number of performance measurement products in the marketplace,” says Craig Heatter, Performance Measurement, Analytics and Risk Management executive, JPMorgan Investor Services. “We substantially reviewed every performance technology that was considered top-notch in the marketplace and determined that although there were some good products out there, none had the right mix of intellectual capital and state-of-the-art technology that we were looking for... none were market leading.”

“Driven by the demands of our clients, who are industry leaders themselves,” Heatter explains, “JPMorgan’s Business and Technology partners developed this first generation, extremely comprehensive product, Performance VIEWS, into what we believe to be a leading edge performance, analytics and risk, client reporting application.”

“Leveraging JPMorgan’s depth, breadth and scale, Investor Services continually strives to meet the dynamic requirements of the financial services industry. Delivering added value to our clients through a technologically advanced financial reporting infrastructure is the key to continuing to build on already strong business relationships,” Heatter says. “We now have, and will continue to build on, an infrastructure and architecture that can continually and easily be enhanced to meet clients’ expanding needs. In addition the VIEWS platform will also provide the necessary tools for our relationship, client service and product management teams to continue to provide the superior level of service that meets the needs of an ever evolving marketplace.”

VIEWS Performance is only the first tranche of an exciting, easy to use, VIEWS product. Additional enhancements include: state-of-the-art Custody, Cash, Accounting and Securities Lending reporting suites to optimize our clients’ portfolios and significantly augment the client experience. Look to future issues of *Thought* magazine for more details. ○○○

For more information contact your relationship manager or client service officer.

any VIEW... any time

- ▶ A user-friendly interface which is simple to use with easy, intuitive navigation and minimal clicks
- ▶ Customized reports on demand or via the scheduler in multiple formats (PDF, HTML, EXCEL) and multiple delivery options
- ▶ *Report Wizard* provides optimal flexibility and drill down and is easy to use for interrogating the database for information to create customized reports
- ▶ Advanced modeling tools for Investment Ledger reporting
- ▶ Advanced presentation capability including charts and graphs for board quality reports
- ▶ Quick access to information using the query capability
- ▶ New home page “dashboard”, permitting client customization of data and links which can be displayed on the page
- ▶ Completely flexible report writing capability, allowing users to choose and order data elements to be displayed on reports
- ▶ New “alert” capability, allowing instant access to information such as trade fails, expiring corporate actions, compliance breaks and significant market events
- ▶ A new “quick query” capability, permitting instant access to key data such as asset or cash balances, which will become accessible without running an actual report

The result, according to Christopher Martin, Global Investment Products executive, JPMorgan Investor Services, “Will be an expanded product suite offering clients access to what we believe is the widest array of short-term investment alternatives available from any custodian.”

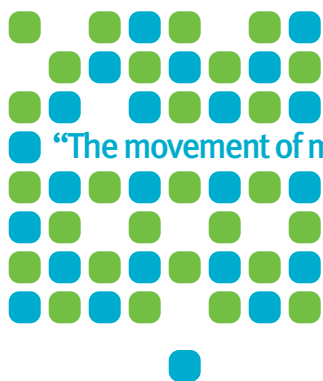
The Funds' merger will expand JPMorgan's flagship short-term offering, the Prime Money Market Fund, to over \$70 billion in assets, making it one of the world's largest money market funds. In addition, as a fund complex, JPMorgan Fleming Asset Management will become one of the world's largest managers of institutional cash and money market funds.

“The scale we will gain from merging the two fund complexes creates a greater degree of liquidity for our clients,” says Bob Deutsch, head of the Global Cash Business for JPMorgan Fleming Asset Management. “The larger funds will offer greater flexibility by alleviating clients’ concerns over being a major shareholder of any one fund. This demonstrates the added benefit of having larger funds overall. Further, the additional scale gives JPMorgan increased strength in the marketplace which in turn is also very meaningful for clients.”

“Given the inherent inefficiencies in the clearing and settlement process, clients will always have some amount of residual cash,” says Martin. “In addition, clients also have a wide range of short-term liquidity needs and strategies. Bringing JPMorgan Funds together with the One Group Mutual Funds will only further expand our liquidity solutions, positioning us as we seek to satisfy just about any short-term investment needs our clients might have, conventional or unconventional,” he says.

Following the merger of the two fund groups, the breadth and depth of JPMorgan's already impressive short-term product offering will expand to include several new funds

* Pending the outcome of a proxy vote.



“The movement of money is essentially invisible to our clients... redemptions are immediate.”

including three new international products. “The merger further supports our global business strategy by offering clients every flavor of major fund categories in the U.S. and internationally,” says Deutsch. The merger will also result in two state-specific tax-free funds, Ohio and Michigan, not previously available to Investor Services clients, as well as an additional tax free “national” money market fund called the JPMorgan Municipal Money Market Fund.

Innovative Solutions

“A robust liquidity management strategy using money market funds and other short-term investment products can assist clients in managing performance, and in today’s environment every basis point of return is important,” Martin explains.

JPMorgan continues to develop innovative value added solutions to further expand its short-term product offerings, and assist clients in managing their cash as efficiently as possible. One such innovation is JPMorgan’s *Automated Sweep Program*, which includes a variety of intraday and end of day options.

“This is an all encompassing service for clients,” says Peri Kantor, relationship manager, JPMorgan Fleming Asset Management. “When a client chooses the *Automated Sweep Program*, money in their account can be automatically swept into the fund they chose. Concerns about cut-off times, overdraft exposure and the costly associated penalties are minimized.”

The *Automated Sweep Program* also reduces many of the manual processes associated with short-term investments, such as sending daily trade instructions and other activities clients have had to employ to avoid overdrafts in the past. “Where clients would normally have to wait for the proceeds of a short-term transaction to physically reach JPMorgan or one of its competitor banks, with the *Automated Sweep Program*, and because of the relationship between JPMorgan Investor Services and JPMorgan Fleming Asset Management, the movement of money is essentially invisible to our clients... redemptions are immediate,” Kantor says. “Rather than spending time monitoring cash levels, the *Automated Sweep Program* allows clients to focus on their core revenue building businesses,” Martin adds.

In addition to the Automated Sweep Program, JPMorgan also offers other unique and innovative short-term products, including an option for securities lending clients who do not wish to elect a separately managed approach. “We worked with JPMorgan Fleming Asset Management to develop a commingled investment vehicle to meet the needs of clients,” says Jim Wilson, Investment Management executive, JPMorgan Investor Services Securities Lending. “It’s a way to offer clients more choices regarding growth of their assets,” he says.

“Short-term cash products can play an important role in a client’s asset allocation strategy. With global interest rates on the rise, the benefits offered by cash products are becoming increasingly important,” says Martin. “No matter what a client’s investment strategy or risk requirements, whether they are concerned with capital preservation, liquidity, or yield enhancement, JPMorgan has something to add value to any short-term portfolio.” ○○○

For more information, contact Christopher Martin at (212) 623-4741.

This article is intended solely to report on various investment views held by JPMorgan Fleming Asset Management. Opinions, estimates, forecasts, and statements of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice. We believe the information provided here is reliable but should not be assumed to be accurate or complete. These views may not be suitable for all investors. References to specific securities, asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations. Past performance is no guarantee of future results.

Please note that the general descriptions of the funds contained herein do not constitute a solicitation or offering for any fund and are, of course, subject to the terms of the prospectuses of such funds, which should be reviewed prior to investing in those funds. Among other things, a fund’s prospectus will explain in detail the policies, investment objectives, strategies and risks associated with a given fund. An investment in the Fund is not insured nor guaranteed by the FDIC or any other government agency. Although the Fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the Fund. The Fund is currently waiving fees, which result in higher yields. This voluntary waiver can be removed at any time. A portion of the Tax Free Funds’ income is subject to the Federal Alternative Minimum Tax.

JPMorgan Funds are distributed by JPMorgan Fund Distributors, Inc. One Group Mutual Funds are distributed by One Group Dealer Services, Inc., which is a subsidiary of JPMorgan Chase & Co. Affiliates of JPMorgan Chase & Co. receive fees for providing various services to the fund. Securities may be introduced through JPMorgan Institutional Investments Inc., member of NASD/SIPC.

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JPMorgan Short-term Funds offering includes:

Liquid Assets Money Market Fund

Seeks to provide maximum current income consistent with the preservation of capital and same day liquidity. Invests primarily in commercial paper; certificates of deposit, corporate notes & bonds, time deposits and other high quality short-term obligations. Maximum average maturity: 90 days.

Prime Money Market Fund

Seeks to provide maximum current income for investors who prefer or require a fund with a AAA rating or NAIC-Class 1 approval.¹ Invests primarily in commercial paper of the highest quality category; certificates of deposit, bankers acceptances, time deposits and other high quality short-term obligations. Maximum average maturity: 60 days.

U.S. Government Money Market Fund

Seeks to provide income for clients who want a fund that invests in U.S. government securities and prefer or require a fund with a AAA rating or NAIC-Class 1 approval.¹ Invests primarily in short-term securities, issued or guaranteed by the U.S. Treasury, its agencies or instrumentalities and repurchase agreements, collateralized by those securities, in order to achieve the highest quality ratings available from Standard & Poor's and Moody's. Maximum average maturity: 60 days.

Treasury Plus Money Market Fund

Seeks to provide income for investors who wish to invest in a AAA rated or NAIC-Exempt Class approved fund of U.S. Treasury securities.¹ Invests primarily in obligations issued by the U.S. Treasury, including Treasury bills and notes and repurchase agreements secured by U.S. Treasury obligations. Maximum average maturity: 60 days.

100% U.S. Treasury Securities Money Market Fund

Seeks to provide income to investors that is exempt from certain state and local taxes. Invests exclusively in direct short-term obligations of The U.S. Treasury, which are backed by the full faith and credit of the U.S. government. Maximum average maturity: 90 days.

Federal Money Market Fund

Seeks to provide income exempt from state and local taxes for investors who wish to invest in a AAA rated or NAIC-Exempt Class approved fund.¹ Invests primarily in obligations issued or guaranteed by agencies and instrumentalities of the U.S. government and direct obligations of the U.S. Treasury. Maximum average maturity: 60 days.

Tax Free Money Market Fund²

Seeks to provide income exempt from federal taxes for clients who wish to invest in a AAA rated or NAIC-Class 1 approved fund.¹ Invests primarily in short-term municipal obligations that may include those of individual states, state agencies, municipalities and municipal agencies. Maximum average maturity: 60 days.

1. These ratings are historical and signify that the Fund's safety is excellent with superior capacity to maintain a \$1 Net Asset Value per share. The National Association of Insurance Commissioners' (NAIC's) "approved" status indicated that the Fund meets certain pricing and quality guidelines.

2. A portion of the Tax Free Money Market Fund's income may be subject to the Federal Alternative Minimum Tax.

An investment in a money market fund is not insured by the FDIC or any other government agency. Although money market funds strive to preserve the value of the investment at \$1.00 per share, it is possible to lose money by investing in a money market fund.

For more complete information about JPMorgan Funds, including information about charges and expenses, please call your investment professional for a prospectus or call 1-800-622-4273. Please read it carefully before you invest or send money.

Investments in the funds are not deposits or guaranteed or endorsed by JPMorgan Chase Bank and the shares are not insured by the FDIC, Federal Reserve Board or any other government agency. Investments in mutual funds involve risk, including possible loss of principal.

J.P. Morgan Fund Distributors, Inc. is the Fund's distributor. J.P. Morgan Fund Distributors is located at 1211 Avenue of the Americas, New York, NY 10036.



a full-service response

to the growth of managed accounts

Managed accounts are one of the fastest growing segments of the investment management industry, with \$535 billion in assets as of June 2004, according to Money Management Institute, the national trade organization for the managed account industry. This figure is estimated to exceed \$800 billion by 2006. Among the many factors contributing to the product's growing appeal are the value investors place on the products' transparency, customization and tax efficiency.

In response to clients' demand for managed account services, through a strategic alliance with Vestmark, JPMorgan Investor Services has launched a new comprehensive servicing solution for investment managers and sponsors seeking to outsource their managed account administration. JPMorgan's new service provides a cost-effective outsourcing solution that includes account opening and closing, ongoing account maintenance, performance reporting, and account reconciliation.

Managed accounts go by a variety of names: privately managed accounts, individually managed accounts, separately managed accounts or wrap accounts. While their names may vary, their structure is essentially the same: a portfolio of stocks and/or bonds managed by a professional investment manager to achieve a specific objective of the individual investor. Unlike a mutual fund, in a managed account the underlying securities are owned by the investor.

"Investment managers are turning to global providers like JPMorgan for solutions that can help them increase their competitive advantage. Using JPMorgan's managed-accounts service will allow our clients to reduce operating costs, manage risk and avoid making large investments in service delivery platforms. After freeing up staff and investment dollars, resources will be increasingly available to focus on key objectives, allowing investment managers to concentrate on generating revenues," said Steven A. Smith, Western Hemisphere Financial Institutions Sales executive at JPMorgan Investor Services.

"As more and more investors approach retirement, they are willing to pay for expert and impartial financial advice and for fee-based accounts that offer portfolios tailored to their own personal preferences and growth objectives," says Smith. "But as the business grows, most investment managers have been challenged by the high cost of administering the new accounts. Operational inefficiency and a reluctance to invest considerable resources in new technology platforms are driving the market to outsource the servicing of their managed accounts."

JPMorgan's new servicing platform for separately managed accounts automates many of the labor-intensive processes associated with managed account administration. By integrating Vestmark's technology with JPMorgan Investor Services' state-of-the-art servicing platform, clients will benefit from a flexible, industry leading web-based solution that addresses the needs of investment managers, helping to increase the overall profitability of their managed accounts business. ○○○

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editor's clip

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